

Office of Chief Counsel
Internal Revenue Service

memorandum

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JEBudde

date: May 14, 2002

to: [REDACTED], Team coordinator, LMSB:FS: [REDACTED]

from: RICHARD E. TROGOLO
Associate Area Counsel (LMSB)

subject: [REDACTED]
[REDACTED] & [REDACTED]
EIN: [REDACTED]

This memorandum responds to your request for assistance dated March 25, 2002. This memorandum should not be cited as precedent.

Issue

Do the documents described below submitted by the taxpayer to the IRS Service Center constitute tax returns?

Conclusion

Yes, the documents constitute tax returns. However, these tax returns are incomplete because they omit required information. The taxpayer should be advised that the tax returns are incomplete and should be notified of the possible ramifications of its failure to file complete tax returns.

Facts

[REDACTED] is the parent corporation of an affiliated group of corporations. [REDACTED] files a consolidated tax return which includes the operating results of itself and numerous subsidiaries. While the Form 1120-PC filed by [REDACTED] contains consolidated taxable income amounts and also computes the consolidated income tax liability, the tax returns omit consolidated balance sheets and some separate corporation balance sheets. In addition, the tax return fails to fully complete Schedules M-1 and M-2. The taxpayer fails to reconcile book income with taxable income on Schedule M-1. The taxpayer also fails to provide consolidated Schedules A, B, C, E and F.

██████████ admits the omission and defends its actions by advising that it has been filing tax returns in this fashion for many years. The IRS Service Center accepts these documents as tax returns without hesitation. ██████████ also claims that if it complied with all the rules and supplied all the consolidated schedules, ██████████ would be submitting a tax return which would be too voluminous. ██████████ also states that it supplies the missing information in response to IDRs issued by IRS agents during the audit.

Analysis

Section 1501 of the Code provides that an affiliated group of corporations shall, subject to the provisions of this chapter, have the privilege of making a consolidated return with respect to the income tax imposed by Chapter 1 for the taxable year in lieu of separate returns. The making of a consolidated return shall be upon the condition that all corporations which at any time during the taxable year have been members of the affiliated group consent to all the consolidated return regulations prescribed under section 1502 prior to the last day prescribed by law for the filing of such return. The making of a consolidated return shall be considered as such consent.

Section 1502 of the Code provides that the Secretary shall prescribe such regulations as he may deem necessary in order that the tax liability of any affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, may be returned, determined, computed, assessed, collected, and adjusted, in such manner as clearly to reflect the income tax liability and the various factors necessary for the determination of such liability, and in order to prevent avoidance of such tax liability.

Section 1.1502-75(a)(1) of the Income Tax Regulations states, in pertinent part, that a group which did not file a consolidated return for the immediately preceding taxable year may file a consolidated return in lieu of separate returns for the taxable year, provided that each corporation which has been a member during any part of the taxable year for which the consolidated return is to be filed consents to the regulations under section 1502. Section 1.1502-75(a)(2) of the regulations provides that a group which filed (or was required to file) a consolidated return for the immediately preceding taxable year is required to file a consolidated return for the taxable year unless it has elected to discontinue filing consolidated returns.

Section 1.1502-75(j) of the regulations provides that the

statement of gross income and deductions and the schedules required by the instructions on the return shall be prepared and filed in columnar form so that the details of the items of gross income, deductions, and credits for each member may be readily audited. Such statements and schedules shall include in columnar form a reconciliation of surplus for each corporation, and a reconciliation of consolidated surplus. Consolidated balance sheets as of the beginning and close of the taxable year of the group, taken from the books of the members, shall accompany the consolidated return and shall be prepared in a form similar to that required for reconciliation of surplus.

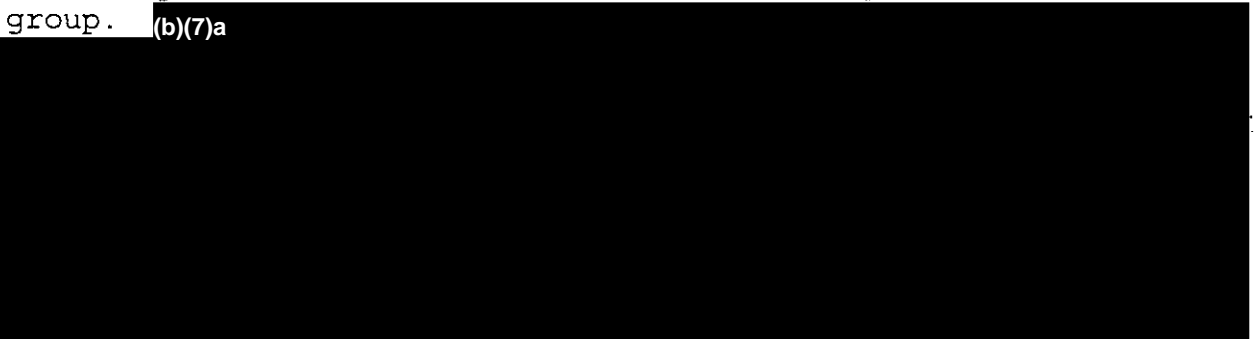
The instructions for the tax return require filing consolidated balance sheets as well as consolidated Schedules A through M, where applicable. [REDACTED] is not filing all these required consolidated schedules with its tax return. You question whether this document constitutes a tax return. We believe it does because the tax liability of the group can be returned, determined, computed, assessed, collected, and adjusted. I.R.C. § 1502.

The traditional standard for determining whether a document is a tax return was set forth in United States v. Porth, 426 F.2d 519, 523 (10th Cir.), cert. denied, 400 U.S. 824 (1970)

A taxpayer's return which does not contain any information relating to the taxpayer's income from which the tax can be computed is not a return within the meaning of the Internal Revenue Code or the regulations adopted by the Commissioner.

The Porth case arose in a criminal tax context. Our situation is clearly not a criminal tax context. Nevertheless, the same definition would probably apply, and under this definition, the documents submitted by [REDACTED] would constitute tax returns.

Although these documents constitute tax returns, they remain incomplete. The law provides some alternatives for you to compel compliance of the regulations by the taxpayer. You have the authority to terminate the consolidated filing privileges of the group. (b)(7)a



(b)(7)a

Another approach to resolving this matter would be to use the available penalties and additions to tax to compel compliance with the consolidated tax return requirements. You should notify the taxpayer that pursuant to I.R.C. § 6662(a), a negligence penalty can be applied to an underpayment of tax. The taxpayer's failure to supply the required schedules is an act of negligence. Should your examination ultimately determine an underpayment of tax, the penalty could be applied.

Conclusion

We believe the documents submitted by the taxpayer constitute tax returns. Consequently, we should not advise the taxpayer that it has failed to file tax returns. However, we should advise the taxpayer that it is required to file all the consolidated schedules with its tax return, and the omission of many of these tax returns brings into question the taxpayer's consolidated tax return election and the applicability of penalties (if an underpayment is determined). Should you have any questions about this advice, please contact John E. Budde at 513-263-4857. A copy of this memorandum will be sent to our national office for post review.

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

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(Large and Mid-Size Business)

By: _____
JOHN E. BUDDE
Senior Attorney (LMSB)